

# **Report of the auditor-general to the Eastern Cape Provincial Legislature and the council of Alfred Nzo District Municipality on the Alfred Nzo District Municipality**

## **Report on the consolidated and separate financial statements**

### **Introduction**

1. I have audited the consolidated and separate financial statements of the Alfred Nzo District Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2015, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the consolidated and separate financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of the consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipal entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes

evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Irregular expenditure

6. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 41 to the consolidated and separate financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R39,9 million (2014: R82,4 million). Due to the lack of systems and sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure, and it was not possible to confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosed at R199,8 million (2014: R21,2 million) in note 41 to the consolidated and separate financial statements.

### Property, plant and equipment (PPE)

7. The entity did not account for its PPE in accordance with GRAP 17, *Property, plant and equipment* in the following circumstances. The following anomalies were identified in terms of Assets under construction (AUC):
  - AUC were not accurately recorded.
  - The AUC register was incomplete.
  - Completed projects were not removed from the AUC schedule.
  - AUC disclosed in note 3 did not agree with the AUC register.
  - Recorded amounts in the AUC register did not agree with supporting documentation.
  - AUC opening balance was overstated.
8. Consequently, AUC as disclosed in note 3 is overstated by R632,4 million (2014: R137,1 million), accumulated surplus disclosed in the statement of changes in net assets is overstated by R153,7 million (2014: (R137,1 million)), payables from exchange transactions disclosed in note 19 are overstated by R409,5 million and property, plant and equipment disclosed in note 3 is understated by R69,2 million.
9. The municipality did not account for other categories of PPE in accordance with GRAP 17, *Property, plant and equipment* correctly as disclosed in note 3 and the following matters were identified:
  - The asset register did not cast.
  - Differences were found between the general ledger, asset register and financial statements.
  - PPE notes did not agree with category totals in the fixed asset register (FAR).

- Land and buildings were not under the control of the municipality.

10. Consequently, PPE as disclosed in note 3 is overstated by R27,6 million (2014:R14,2 million) and payables from exchange transactions disclosed in note 19 is understated by R13,4 million and accumulated surplus in the statement of changes in net assets in 2014 is understated by R14,2 million.

11. In addition, I was unable to obtain sufficient appropriate audit evidence for PPE due to the following matters:

- Inadequacy of the filing system over AUC.
- Inadequate processes or procedures to confirm ownership of or control over land and buildings in order to confirm the opening balance raised.
- Unexplained differences between the financial statements, trial balance and FAR.
- Journals not supported by appropriate evidence.

12. I was unable to confirm the amount of PPE by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment of R2,4 billion million (2014: R1,9 billion) as disclosed in note 3 to the financial statements.

### **Payables from exchange transactions**

13. The municipality did not have adequate systems in place to identify and record all payables as required by section 63(2)(b) of the MFMA. Payables from exchange transactions, disclosed in note 19 to the consolidated and separate financial statements, is understated by R37 million and general expenditure disclosed in note 31 to the consolidated and separate financial statements is understated by R37 million in respect of amounts that were identified during the audit process. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of payables from exchange transactions as disclosed in note 19 to the consolidated and separate financial statements.

### **Commitments**

14. GRAP 17: *Property, plant and equipment* requires the disclosure of contractual commitments for the acquisition on property, plant and equipment. The municipality did not fully comply with this requirement as the manual commitments register that was prepared was found to have numerous deficiencies. An adequate record of commitments was not maintained and reviewed for accuracy by the municipality for the year under review. Invoices inspected did not agree with the disclosed amounts in the commitments register. This resulted in an overstatement of R195,5 million (2014:R1,6 billion) of commitments disclosed in note 35 to the consolidated and separate financial statements.

15. Furthermore, not all contracts supporting the original capital commitment raised could be provided to substantiate the disclosed amount for commitments. Due to the non-availability of sufficient appropriate audit evidence I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine if any adjustments were required to commitments of R945,5 million as disclosed in note 35 to the financial consolidated and separate statements.

## **Unauthorised expenditure**

16. The municipality is required to disclose unauthorised expenditure in terms of sections 1 and 125(2)(d) of the MFMA. The municipality overspent the budget for technical services by R70,6 million (2014: R106,8 million), but did not make the required disclosure in note 39. Consequently, unauthorised expenditure is understated by R177,5 million (2014: R106,8 million) as disclosed in note 39 to the consolidated and separate financial statements.

## **Statement of comparison of budget and actual amounts**

17. The municipality did not disclose the statement of comparison of budget and actual amounts in accordance with GRAP 24: *Presentation of budget information in consolidated and separate financial statements, as follows:*

- The municipality did not prepare the budget on a comparable basis as some items were presented on the cash basis of accounting.

18. Sufficient appropriate audit evidence was not presented for budget variances. I was unable to confirm this by alternative means. Consequently, I could not determine if any adjustments were required to the statement of comparison of budget and actual amounts as disclosed in the consolidated and separate statements financial statements.

## **Aggregation of immaterial uncorrected misstatements**

19. The consolidated and separate financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the consolidated statement of financial position, statement of financial performance to the consolidated and separate financial statements:

- Intangible assets reflected as R3,6 million in note 4 was understated by R3,6.
- Provisions reflected as R23,8 million in note 16 was overstated by R7,5 million.
- Receivables from exchange transactions reflected as R22,9 million in note 10 was overstated by R4,4 million.
- Accumulated surplus reflected as R2,4 billion in the statement of changes in net assets was overstated by R10,8 million.
- Employee costs as reflected as R195,7 million in note 26 were understated by R17,6 million.
- General expenditure as reflected as R127,8 million in note 31 was overstated by R15,5 million.
- Transfers and subsidies reflected as R60,6 million in the statement of financial performance was overstated by R6,4 million.
- Service charges reflected as R18,8 million in note 21 was overstated by R8 million.
- Interest received reflected as R19,9 million in note 23 was understated by R7,5 million.

- Repairs and maintenance reflected as R29,3 million in the statement of financial performance was overstated by R6,8 million.
- Depreciation reflected as R51,8 million in the statement of financial performance was overstated by R6,9 million.

20. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:

- Receivables from exchange of R7,9 million as included in the disclosed balance of R22,9 million in note 10.
- Accumulated surplus of R6,6 million as included in the statement of changes in net assets of R2,4 billion.

21. Consequently, I was unable to determine whether any further adjustments to these items were necessary.

### **Corresponding figures**

I identified the following misstatements which are included in the corresponding figures disclosed in the current period's financial statements:

### **Financial instruments**

22. GRAP 104: *Financial instruments* requires the disclosure of categories of financial assets and liabilities. The municipality overstated call deposits in note 34 by R101,4 million. Consequently, financial instruments as disclosed in note 34 is overstated by R101,4 million.

### **Contingent liabilities**

23. I was not able to obtain all the attorney confirmations to ensure the completeness of the contingent liability disclosure. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to contingent liabilities of R19,7 million as disclosed in note 36 to the consolidated and separate financial statements.

My audit opinion on the financial statements for the period ended 2013-14 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

### **Qualified opinion**

24. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Alfred Nzo District Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

25. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

26. As disclosed in note 37 to the consolidated and separate financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 30 June 2015 in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2014.

### **Material losses**

27. As disclosed in note 9.1 to the consolidated and separate financial statements, material losses to the amount of R 37,2 million (2014: R 54,3 million) were incurred as a result of water losses.

### **Additional matters**

28. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure notes**

29. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, I do not express an opinion thereon.

## **Report on other legal and regulatory requirements**

30. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities objectives presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

31. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for KPA 1: Basic Service Delivery and Infrastructure Development on pages x to x presented in the annual performance report of the municipal entity for the year ended 30 June 2015.

32. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

33. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles

and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

34. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

The material findings in respect of the KPA are as follows:

## **Basic Service Delivery and Infrastructure Development**

### **Usefulness of reported performance information**

35. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 24% of the reported objectives were not consistent with those in the approved integrated development plan. This is due to the lack of appropriate systems and processes to ensure that reporting are complete for all planned indicators and targets set.
36. The FMPPI requires that the period or deadline for delivery of targets must be specified. A total of 39% of the targets were not time bound. This was because management was not trained in the requirements of the FMPPI.

### **Reliability of reported performance information**

37. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of standard operating procedures and frequent review of the validity of reported achievements against source documentation.

### **Additional matters**

38. We draw attention to the following matters. Our conclusion is not modified in respect of these matters:

### **Achievement of planned targets**

39. Refer to the annual performance report on page(s) X to X for information on the achievement of planned targets for the year.

### **Unaudited supplementary information**

40. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## **Compliance with legislation**

I performed procedures to obtain evidence that the municipal entity had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### **Strategic planning and performance management**

41. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
42. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance planning monitoring, measurement, review, reporting, improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the municipal planning and performance management regulations.

### **Annual report and annual financial statements**

43. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

### **Expenditure management**

44. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Asset management**

45. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
46. All investments were not made in accordance with the requirements of the investment policy as quotations were not obtained, as required by municipal investment regulation 3(3).

### **Liability management**

47. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

### **Audit committee**

48. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).
49. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

### **Consequence management**

50. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
51. Authorisation of unauthorised expenditure was not done through an adjustment budget in the financial year, as required by section 32(2)(a)(i) of the MFMA.

### **Procurement and contract management**

52. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
53. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
54. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
55. Contracts were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
56. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
57. Contracts were modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
58. Contracts were modified without the approval of a properly delegated official, as required by SCM regulation 5.
59. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
60. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

### **Internal control**

I considered internal control relevant to my audit of the consolidated and separate financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

### **Leadership**

61. Leadership did not take full ownership of the general control environment and did not insist on daily disciplines to ensure efficiency and effectiveness in financial management,

service delivery execution and compliance with laws and regulations. Consequently, the correct tone was not set to ensure the credibility of all reports of the administration and leadership did not hold officials accountable for their actions through a consequence management programme.

62. Vacancies and instability in key management positions and support functions negatively impacted the municipality's ability to respond to prior period findings. In addition, the support provided by consultants did not yield the desired results as the leadership did not introduce all the required mechanisms to ensure that consultants deliver expected outputs.
63. Leadership did not ensure effective working relationships between staff responsible for core services and reporting functions, which had a negative impact on the credibility of financial and performance reporting.
64. Leadership had not fully implemented the audit turnaround strategy that was approved by the council.

## **Financial and performance management**

65. Management did not implement all the appropriate daily, weekly and monthly processes, procedures and controls to ensure that all transactions were accurately recorded, classified, reconciled, approved, filed and reported on in accordance with GRAP and with the National Treasury's FMPPI. These omissions hampered effective financial and performance management, reporting and oversight and have been highlighted in my past three reports.
66. The lack of financial discipline and monitoring throughout the financial year resulted in a large number of reconciliations, journals and corrections being performed after year-end. In addition, leadership did not ensure that the consolidated and separate financial statements agreed with supporting documentation prior to its submission for audit.
67. Management did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation such as the MFMA, SCM Regulations.
68. Management did not address key challenges identified in regulating the information technology control environment in the areas of user access, security management, IT service continuity, programme change management and application controls. These weaknesses have highlighted in my report for the past three financial years.
69. Leadership has not hold officials accountable for poor performance as evidenced by the repeat nature of findings raised.

## **Governance**

70. The municipality has an audit committee and internal audit unit in place. However, insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information as well as performance objectives were addressed.
71. Management failed to implement the recommendations made by the audit committee, internal audit and external audit which resulted in a number of repeat audit findings in the current year.
72. The audit committee did not meet the required four times as required by the MFMA and did not report to council with regards to the performance management system.

AUDITOR-GENERAL

East London

22 December 2015



*Auditing to build public confidence*